

Letter of Findings Number: 09-0093
Sales Tax
For Tax Years 1998-2004

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ISSUES

I. Sales Tax—Mining Exemption.

Authority: Indiana Dep't of State Revenue v. Interstate Warehousing, Inc., 783 N.E.2d 248 (Ind. 2003); IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-7; IC § 6-2.5-4-10; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; IC § 6-2.5-8-1; IC § 6-8.1-5-1.

Taxpayer protests the imposition of sales tax and claims that the mining exemption applies to its lessee.

II. Tax Administration—Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a business in Indiana. Taxpayer rented tangible personal property ("TPP") to a related company ("Related") but was not registered as a retail merchant, had never collected or remitted sales tax, and had never filed sales tax returns. Related was Taxpayer's only customer. The Indiana Department of Revenue ("Department") audited Taxpayer for the tax years 1998 through 2004. As the result of the audit, the Department determined that Taxpayer did not collect sales tax on taxable leases it made to Related and that Related did not qualify for the mining exemption. The Department then concluded that Taxpayer, as the retail merchant, should have collected sales tax on the leases. The Department therefore issued proposed assessments for sales tax, ten percent negligence penalties, and interest. The Department reduced the assessments by the amount of sales tax Taxpayer paid for the TPP, since Taxpayer leased the TPP and would have been eligible for the rental and leasing exemption on the original purchases. Taxpayer protests the proposed assessments and states that Related does qualify for the mining exemption. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Sales Tax—Mining Exemption.

DISCUSSION

Taxpayer protests the imposition of sales tax on leases it made to Related. Taxpayer states that Related is eligible for the mining exemption and that Taxpayer was therefore not required to collect sales tax on those leases. Taxpayer states that Related does qualify for the exemption. Related performs drilling functions which Taxpayer states are an integral part of the mining process. Related mines core samples from sites which Related's customers are either considering mining or are about to drill. Related takes the core samples to third-party laboratories to determine the quantity and quality of the vein of ore its customer is trying to follow. Related also tests the strength of the surrounding rock to determine the stability of the area about to be mined. Taxpayer believes that Related qualifies for the exemption found at IC § 6-2.5-5-5.1(b). The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The first relevant statute is IC § 6-2.5-2-1, which states:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state. (Emphasis added).

Also, Indiana imposes a complementary use tax under IC § 6-2.5-3-2(a), which states:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Next, IC § 6-2.5-4-10 provides:

- (a) A person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person other than for subrent or sublease.
- (b) A person is a retail merchant making a retail transaction when the person sells any tangible personal property which has been rented or leased in the regular course of the person's rental or leasing business.
- (c) Notwithstanding subsection (a), a person is not a retail merchant making a retail transaction when the person rents or leases motion picture film, audio tape, or video tape to another person. However, this

exclusion only applies if:

- (1) the person who pays to rent or lease the film charges admission to those who view the film; or
- (2) the person who pays to rent or lease the film or tape broadcasts the film or tape for home viewing or listening.

(Emphasis added).

Also of relevance is IC § 6-2.5-8-1(a), which states:

(a) A retail merchant may not make a retail transaction in Indiana, unless the retail merchant has applied for a registered retail merchant's certificate.

Next, IC § 6-2.5-3-7 states:

(a) A person who acquires tangible personal property from a retail merchant for delivery in Indiana is presumed to have acquired the property for storage, use, or consumption in Indiana. However, the person or the retail merchant can produce evidence to rebut that presumption.

(b) A retail merchant is not required to produce evidence of nontaxability under subsection (a) if the retail merchant receives from the person who acquired the property an exemption certificate which certifies, in the form prescribed by the department, that the acquisition is exempt from the use tax.

(c) A retail merchant that sells tangible personal property to a person that purchases the tangible personal property for use or consumption in providing public transportation under [IC 6-2.5-5-27](#) may verify the exemption by obtaining the person's:

- (1) name;
- (2) address; and
- (3) motor carrier number, United States Department of Transportation number, or any other identifying number authorized by the department.

The person engaged in public transportation shall provide a signature to affirm under penalties of perjury that the information provided to the retail merchant is correct and that the tangible personal property is being purchased for an exempt purpose.

(Emphasis added).

Next, IC § 6-2.5-5-3 states:

(a) For purposes of this section:

- (1) the retreading of tires shall be treated as the processing of tangible personal property; and
- (2) commercial printing shall be treated as the production and manufacture of tangible personal property.

(b) Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

(c) The exemption provided in subsection (b) does not apply to transactions involving distribution equipment or transmission equipment acquired by a public utility engaged in generating electricity.

(Emphasis added).

Finally, IC § 6-2.5-5-5.1 provides:

(a) As used in this section, "tangible personal property" includes electrical energy, natural or artificial gas, water, steam, and steam heat.

(b) Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

Therefore, the TPP must be directly used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property in order to be exempt from sales tax under either IC § 6-2.5-5-3 or IC § 6-2.5-5-5.1(b).

The Indiana Supreme Court has provided guidance on this issue in *Indiana Dep't of State Revenue v. Interstate Warehousing, Inc.*, 783 N.E.2d 248 (Ind. 2003). The Indiana Supreme Court explained that the Indiana Tax Court had addressed the exemption in several prior cases. The court stated:

The common thread in all of these cases is that where the taxpayer did not transform property into a distinct marketable product for customer consumption, the Tax Court held that the taxpayer was not engaged in the "production of other tangible personal property." We agree with the Tax Court's analysis in those cases. *Id.* at 251.

As provided above by the court in *Interstate Warehousing*, any taxpayer claiming the exemption provided by IC § 6-2.5-5-5.1 must transform property into a distinct marketable product for customer consumption in order to qualify for the exemption. This requirement also applies to the exemption provided by IC § 6-2.5-5-3.

Taxpayer refers to several statutes and regulations which it believes support its position that Related is in the mining business. Taxpayer also refers to a Letter of Findings ("LOF") which discusses several court cases which Taxpayer believes support its position. It must be noted that LOFs apply only to the taxpayers to whom they are

issued. Also, while the taxpayer discussed in that LOF also provided services to mining businesses, the LOF denied that taxpayer's protest based on the same reasons under discussion in the instant LOF. Taxpayer points out that a previous version of IC § 6-2.5-5-3(b), as discussed in those cases, had the word "his" in it, using the language, ". . . transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use in the direct production. . . ." Taxpayer has not established why this makes a difference. The fact remains that Related did not use the equipment it leased from Taxpayer to produce tangible personal property.

Taxpayer's references to these statutes, regulations, and cases are misplaced, since Related does not transform property into a distinct marketable product for customer consumption. Related drills core samples for mine owners. Those core samples are delivered to a laboratory for testing. Related does not sell the core samples to the mine owners or to anyone else. The drilling and delivery of core samples and the testing of surrounding rock for strength are not activities which produce a marketable product. Rather, Related provides a service to its customers. While the service is certainly valuable to the mining companies, it is not the production of a distinctly marketable product. Therefore, as provided by IC § 6-2.5-5-3, IC § 6-2.5-5-5.1, and as explained by the court in *Interstate Warehousing*, Related is not eligible for the mining exemption.

In conclusion, Taxpayer was acting as a retail merchant as defined by IC § 6-2.5-4-10(a). Since Related is not eligible for the mining exemption, as provided by IC § 6-2.5-5-3, IC § 6-2.5-5-5.1, and *Interstate Warehousing*, Taxpayer should have been collecting sales tax on the leases for the equipment which Taxpayer leased to Related. While a retail merchant is not required to produce evidence of nontaxability if it receives a properly completed exemption certificate under IC § 6-2.5-3-7(b), Taxpayer did not receive any exemption certificates from Related. In fact, Taxpayer was not even registered as a retail merchant, as required by IC § 6-2.5-8-1(a). Taxpayer should have registered as a retail merchant and should have collected sales tax on the leases of equipment to Related, since Related was not eligible for the mining exemptions. Taxpayer has not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

II. Tax Administration–Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...

the person is subject to a penalty.

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer incurred a deficiency which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). As explained in Issue I, Taxpayer not only failed to properly collect sales tax when it had not received exemption certificates, Taxpayer also failed to register as a retail merchant. Taxpayer has not affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer's protest is denied on Issue I regarding imposition of sales tax. Taxpayer's protest is denied on Issue II regarding imposition of negligence penalties.

Posted: 11/25/2009 by Legislative Services Agency
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